

October 01, 2020

NMDC Limited: Revision in rating watch from developing to negative implications

Summary of rating action

Instrument [^]	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Proposed Non-Convertible Debenture (NCD) Programme	5,000.00	4,476.20	[ICRA]AAA@; Revision in rating watch from developing to negative implications
NCD Programme	-	523.80	[ICRA]AAA@; Revision in rating watch from developing to negative implications
Total	5,000.00	5,000.00	

[^]Instrument details are provided in Annexure-1

Rationale

The revision in rating watch on NMDC Limited's (NMDC) [ICRA]AAA rating from developing to negative implications reflects the continuing uncertainty regarding the debt servicing arrangement to be made by NMDC Iron & Steel Plant (NISP) in the initial period post the demerger. While the debt servicing would be met by NMDC till the demerger, as per the demerger scheme, the obligation would shift to the new entity once the demerger is complete. This, in turn, would exert pressure on the rating as the credit profile of NISP would be much weaker than that of NMDC since it does not have any track record in the steel industry and would take some time in ramping up and stabilising its steel business. ICRA also notes that NISP would have a mirror shareholding of NMDC and the Rs. 17,000 crore invested by NMDC towards the steel plant till date would be transferred to NISP as equity, thereby weakening the net worth of NMDC. ICRA will continue to monitor these developments.

The rating takes into consideration NMDC's status as the largest iron ore miner in India with its mines having adequate reserve of good quality ore and its strong capital structure and debt coverage indicators. The total reserves of its mines stood at 1,840 million tonnes (mt) as on April 1, 2019 with average Fe content of 63-65%. The company has environmental clearance (EC) approved capacity of 51.8 mt and reported average annual production of 32.6 mt during the past four fiscals. The rating also draws comfort from the company's *Navratna* status under the Ministry of Steel, Government of India (GoI), with the latter holding a 69.7% stake in the company as on June 30, 2020. Besides the sovereign ownership, the company's superior liquidity profile, supported by a healthy cash balance of about Rs. 2,437 crore as on March 31, 2020, impart it with a high degree of financial flexibility. Nevertheless, ICRA notes that the company remains exposed to the cyclicity inherent in the steel industry and to regulatory risks associated with the mining operations.

- » The liability towards the proposed NCD proceeds shall be transferred to the demerged entity (NISP), without the need for any separate consent solicitation exercise from the debenture holders.
- » Post the demerger, in case the credit rating of the demerged entity is downgraded to AA+ or below anytime till the maturity of the NCDs, then the coupon rate shall be enhanced further by additional 25 basis points for each notch of rating downgrade below AAA, and such enhanced coupon shall be payable effective from the date of rating downgrade.
- » In the event of delay in payment of interest amount and/or principal amount on the due date(s), the company shall pay additional interest of 2% per annum in addition to the respective coupon rate payable on the bonds, on such amounts due, for the defaulting period i.e. the period commencing from and including the date on which such amount becomes due and upto but excluding the date on which such amount is actually paid.

Salient terms as specified in the term sheet

Key rating drivers and their description

Credit strengths

Status as the largest iron ore mining company in India – NMDC was incorporated in 1958 and is the largest iron ore miner in India with its mines having adequate reserve of good quality ore. Its total reserves stood at 1,840 mt as on April 1, 2019. During the past four fiscals, the company reported an average annual production of 32.6 mt, which is 17% of the total iron ore produced in India during that period. The company has seven iron ore mines in four different locations – Kirandul, Bachel (in Chhattisgarh), Donimalai and Kumarswami (in Karnataka) with existing EC approved capacity of 51.8 mtpa.

Significant sovereign ownership and strategic importance to the GoI – NMDC is a flagship company under the Ministry of Steel, with a *Navratna* status. The GoI has 69.7% ownership in NMDC as on June 30, 2020 and is also of strategic importance to the Government, given its status as the largest iron ore producer in India.

Superior liquidity profile – NMDC's financial risk profile has remained comfortable over the years as reflected by its debt-free status till FY2020 and strong liquidity profile. Despite regular dividend pay-outs, NMDC's unencumbered cash balance remained healthy, at about Rs. 2,437 crore as on March 31, 2020.

Healthy profitability owing to high-margin iron ore mining business – NMDC's operating profitability remained strong in the range of 50-60% during the last three fiscals. In FY2020, the company reported an operating margin of 51.3% (57.0% in FY2019) and this was mainly on account of its low-cost mining operations (mining cost excluding taxes of about Rs. 770 per metric tonne) and the high-grade of its iron ore deposits. The average Fe grade of NMDC's Bailadila mines stood at 65% and that of Donimalai mines stood at 63%.

Credit challenges

Transfer of debt servicing liability to NISP, which would have a weaker credit profile – ICRA takes note of the transfer of debt servicing obligation of the rated NCDs from NMDC to NISP post the demerger of the steel business, which would have a weaker credit profile compared to NMDC. ICRA also notes that the demerger process

would take eight to nine months and the new entity would be listed on stock exchanges to achieve a mirror shareholding same as NMDC. While the detailed demerger scheme is yet to be finalised, future debt servicing by NISP from its own cash flows and the overall transaction structure would remain a key credit monitorable.

Exposure to cyclical risk in steel sector– Iron ore is used as an input in the steel manufacturing process. NMDC, like other iron ore miners, remains exposed to the cyclical risk inherent in the steel sector. A prolonged downturn in steel industry might put a pressure on NMDC’s production levels and impact its cashflows. ICRA also notes that a major part of the company’s iron ore output is sold to three customers viz. Essar Steel, Rastriya Ispat Nigam Limited and JSW Steel Limited, thereby exposing it to high sales concentration risk.

Exposure to regulatory risks related to mining business – NMDC remains exposed to the regulatory risks associated with the mining business. ICRA notes that the Donimalai iron ore mine has been non-operational post the expiry of mining lease in November 2018. The cabinet approval for lease renewal was received in September 2020 and the mine is likely to start production in a couple of months. Going forward, the risk of a timely renewal of the other mining leases is minimal given the amendment of the Mines and Mineral Regulation (Development) Act by the Central Government to make it mandatory for all the state governments to renew the mining leases of public sector companies for a period of 20 years on the expiry of a current lease.

Also, as per the Supreme Court (SC) guidelines, the company’s entire sales in Karnataka are currently routed through a monitoring committee (MC) set up by the apex court. The MC retains 10% of the sales proceeds towards reclamation and rehabilitation plan (R&R plan). The R&R plan has been approved by the Central Empowered Committee (CEC) and the matter is pending with the SC for the release of 10% amount.

Liquidity position: Superior

NMDC’s liquidity position remains **superior** supported by its healthy cash generation from the mining business. While the company has NCDs of Rs. 523.8 crore on its books, the repayment would be due in August 2025. Given the large unencumbered cash balances of Rs. 2,331.9 crore as on March 31, 2020, unutilised fund-based facilities of Rs. 130 crore with adequate drawing power, and healthy cash generation from the mining business, ICRA expects the company’s liquidity profile to remain comfortable.

Rating sensitivities

Positive triggers – Not applicable

Negative triggers – Negative pressure on the rating would emerge post the demerger event due to weaker standalone credit profile of NISP.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating methodology for Mining Entities Entities in the Ferrous Metals Industry
Parent/Group Support	Not applicable
Consolidation / Standalone	For arriving at the ratings, ICRA has considered the consolidated financial risk profile of NMDC Limited. As on March 31, 2020, NMDC Limited had 8 subsidiaries, 6 joint venture companies and 5 associate companies. These are enlisted in Annexure-2.

About the company

NMDC was incorporated in 1958 and is currently under the administrative control of the Ministry of Steel, GoI. Mr. Sumit Deb is the chairman and managing director of the company. NMDC is involved in the exploration of a wide range of minerals including iron ore, copper, rock phosphate, lime stone, dolomite, gypsum, bentonite, magnesite, diamond, tin, tungsten, graphite, beach sands, etc. and is also the largest iron ore producer in India. At present, it produces more than 30 million tonnes (mt) of iron ore from Bailadila Deposit-14/11C, Bailadila Deposit-5, 10/11A (Chhattisgarh) and Kumarswamy Iron Ore Mines (Karnataka).

As per the provisional financials for Q1 FY2021, NMDC reported a profit after tax (PAT) Rs. 531.8 crore on an operating income (OI) of Rs. 1,937.5 crore compared to a PAT of Rs. 3602.3 crore on an OI of Rs. 11699.2 crore in FY2020.

Key financial indicators

	FY2019	FY2020
Operating Income (Rs. crore)	12152.7	11699.2
PAT (Rs. crore)	4637.5	3602.3
OPBDIT/OI (%)	57.0%	51.3%
PAT/OI (%)	38.2%	30.8%
Total Outside Liabilities/Tangible Net Worth (times)	0.1	0.1
Total Debt/OPBDIT (times)	0.1	0.1
Interest Coverage (times)	171.8	607.5

Note: OPBDIT: Operating Profit before Depreciation, Interest and Taxes; Source: NMDC

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2021)					Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding	Rating		FY2020	FY2019	FY2018
					01-Oct-2020	07-Sep-2020	23-Mar-2020		
1	Proposed NCD	Long term	4,476.20	-	[ICRA]AAA@; Revision in rating watch from developing to negative implications	[ICRA]AAA&; Placed on rating watch with developing implications	[ICRA]AAA (Stable)	-	-
2	NCD	Long term	523.80	523.80	[ICRA]AAA@; Revision in rating watch from developing to negative implications	-	-	-	-

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Proposed NCD	-	-	-	4,476.20	[ICRA]AAA@; Revision in rating watch from developing to negative implications
INE584A08010	NCD	August 28, 2020	7.3%	August 28, 2025	523.80	[ICRA]AAA@; Revision in rating watch from developing to negative implications

Source: NMDC

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
J&KMDC Ltd	95.86%	Full consolidation
NMDC Power Ltd	100%	Full consolidation
Legacy Iron Ore Ltd	78.56%	Full consolidation
Karnataka Vijaynagar Steel Ltd	100%	Full consolidation
NMDC Steel Ltd	100%	Full consolidation
Jharkhand Kolhan Steel Ltd	100%	Full consolidation
NMDC SAIL*	100%	Full consolidation
Kopano-NMDC Minerals (Pty) Ltd	50%	Equity method
NMDC-CMDC Ltd	51%	Equity method
Jharkhand National Mineral Development Corporation Ltd	60%	Equity method
NMDC-SAIL Ltd [#]	51%	Equity method
Chhattisgarh Mining Ventures Ltd [#]	26%	Equity method
Bastar Railway Private Ltd	52%	Equity method
Krishnapatnam Railway Co. Ltd	6.40%	Equity method
International Coal Ventures Pvt. Ltd	25.94%	Equity method
Neelachal Ispat Nigam Ltd	12.87%	Equity method
Romelt-SAIL (India) Ltd*	25%	Equity method
Chhattisgarh Mega Steel Ltd	26%	Equity method

Source: NMDC; *Under closure; [#]Under the process of striking off

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